Financial Markets

9/8/83

B4750-1

Irving Trust

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New York, NY 10015

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Friday
(Noon)

Sept. 2, 1983

Hindsight is always much clearer than foresight. And so the statistics reported by the Fed for last week, and the overview from the July 12-13 FOMC meeting, put recent money market events in a clearer light. The Fed has not loosened its policy; in fact, at the July meeting the FOMC voted to tighten somewhat. Still, the Fed operations of the last statement week have been perplexing to some. What is the Fed up to?

Clearly, the Fed is not up to easing its policy. The recent softness in rates reflected a problem with the timing of reserve injections rather than with anything fundamental (this was described in the last "Financial Markets" letter). However, Fed policy has changed. Earlier this year, Fed policy was expressed best by the Fed funds rate. Recently, Fed policy has come to be expressed best by the net borrowed reserve position of banks.

This means that the Fed is somewhat less concerned with strictly controlling the funds rate. Instead, it leaves the market some room to push that rate up or down; the Fed sends its signal through the level of net borrowings. As a result, the Fed funds rate is now more variable than it has been so far this year. Yet the Fed still pays attention to the Fed funds rate, and this explains the somewhat unsettling money market operations by the Fed during the last statement week.

After two weeks of a soft funds rate, the Fed decided a third such week would be a problem. As a result, it drained reserves on Thursday of last week via a matched sale transaction. This operation, while probably not large, left the market with less liquidity and helped to impart some firmness to the funds rate. But late in the week the Fed found the market was insufficiently liquid. It therefore went in on Wednesday and added reserves via a System RP--again probably a small transaction. While the Fed usually loathes draining, then resupplying, reserves in the same week, last week was probably an exception. The Thursday transaction (drain) was a calculated risk: Draining had to be done early or market psychology, tilted toward lower rates, might have gotten out of hand. There was no pressing need to drain reserves overall during the week, but having less liquidity early on was imperative. Then, as the week progressed, no other factors put reserves back in, so the Fed itself had to go back in and undo the effects of its earlier operation. These open market operations do not reflect poor performance by the Fed; rather, they reflect an attempt to regain some control of the funds rate.

The bottom line remains that the Fed prefers a firm funds rate at this time. Still, the July meeting provides some comfort. With Fed funds trading around 9.4% at the time of the meeting, the Fed agreed to exert more pressure on reserve positions but did not change the upper limit of the Fed funds trading range from 10%. While such a change remains as an option, it does not appear that the Fed intends to tighten up much more; but a firmness in rates can be expected to endure for a while longer.

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Market Yields

	9/2/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.63	9.38	10.38
Repurchase Agreements	9.45	9.25	10.13
U.S. Treasury Issues			
Bills			
3 months	9.60	9.45	8.15
6 months	10.13	9.90	9.47
1 year	10.59	10.35	10.02
Coupons			
2 years	11.18	10.93	11.63
4 years	11.66	11.34	14.88
7 years	11.97	11.58	14.50
10 years	12.01	11.70	13.75
Long Bond	11.98	11.66	14.00
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.50	9.25	10.40
3 months	9.70	9.55	10.75
6 months	10.15	9.90	11.75
1 year	10.45	10.30	12.30
Banker's Acceptances			
1 month	9.50	9.35	10.19
3 months	9.85	9.67	11.70
6 months	10.15	10.00	11.70
Eurodollar Deposits			
1 month	10.00	9.75	11.19
2 months	10.18	10.00	11.38
3 months	10.38	10.25	11.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.53	9.27	10.55
1 month	9.59	9.45	10.36
3 months	9.87	9.74	10.40
Bank Holding Companies			
1 month	9.19	9.19	9.19
Dealer Placed:			
3 months	9.71	9.55	10.27
New AA Corporate Utility Bond	13.00	12.95	14.60
Tax Exempt			
6 month Project Notes	5.65	5.35	5.25
1 year AAA Bond	5.70	5.75	7.00
5 year AAA Bond	7.00	7.00	7.75
20 year AAA Bond	9.30	9.10	10.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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